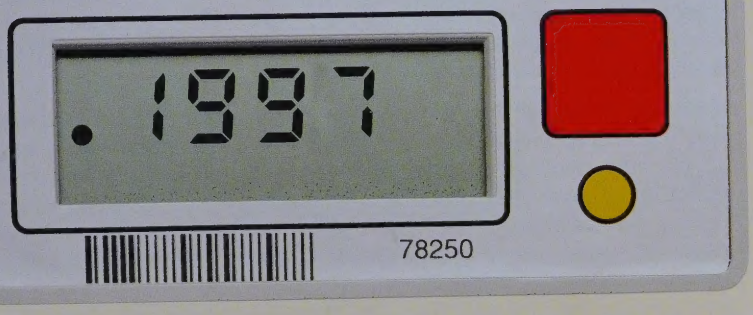
AR59

TELEPANEL SYSTEMS INC

ANNUAL REPORT



PRESIDENT'S MESSAGE

To Our Shareholders:

Telepanel has made excellent progress since our last annual report. Telepanel's operating results showed significant improvement this year as manufacturing expenses declined by $1,580,000, or 40% from last year, while revenue decreased slightly by 3%. Product sales exceeded manufacturing expense by $552,000, or 19.3%, of sales. This improvement is primarily attributable to the lower product costs from our industry leading Millennium 2000 Series product and the renewal of the IBM agreement. Telepanel is the only ESL vendor that has reported a positive gross margin.

There were several other significant milestones that marked important progress during the year. Telepanel expanded its North American marketing channels with an agreement with Fleming Companies to market Telepanel's ESL technology to its 3,500 member stores. Recently we signed an agreement with Associated Wholesale Grocers, Inc. to market our product to its 800 member stores. These agreements broaden Telepanel's market coverage to a segment of the market complementary to that serviced primarily by IBM.

In the second quarter VenGrowth Investment Fund Inc. made its second investment in Telepanel, a firm indicator of its confidence in the company. Telepanel expanded its customer base in the year as it welcomed Stop & Shop, Big Y, Shaw's and Bozzuto's. Telepanel and IBM submitted a successful bid to Stop & Shop to install systems in 33 of its stores in 1997, the agreement for which was signed shortly after year end.

Last September we launched Telepanel Europe S.A. in Paris to market to over 20,000 potential customers for our technology and to support IBM's European initiatives. Investors led by Apax Partners & Cie. agreed to provide $4 million in funding to Telepanel Europe. We subsequently developed a display module specifically for European retailers which is capable of displaying package and unit prices in a variety of European currencies and formats, including the European common currency. The European ESL makes alternate currency prices available to the shopper at the touch of a button. This feature is particularly useful in areas of high international traffic, such as border regions. This technology will enable European supermarkets to rapidly update prices for exchange rate fluctuations at minimal cost. A patent application has been filed to cover these and other unique attributes of the European product.

In October 1996 Telepanel signed the largest customer agreement in its history, covering 70 systems with Edwards Super Food Stores. This agreement is for installations outside of Connecticut, broadening our market coverage in the USA. Installations for the first eight of these systems are in progress. This was a follow-on order after our previous successful installation of 33 stores for Edwards.

During the year Telepanel received a grant from the National Research Council under the Industrial Research Assistance Program (IRAP) to fund a significant portion of our R & D program, to be carried out in conjunction with the world renowned Communications Research Centre (CRC).

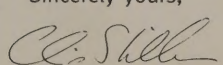
We recently announced Telepanel had engaged Deutsche Morgan Grenfell Inc. and Smith Barney Inc. of New York to privately place up to 4 million common shares in the USA. The proceeds will be used to build on our full-function, lowest-cost product technology through value engineering programs, to increase sales and marketing resources, expand our manufacturing capabilities, and to provide working capital for growth. Deutsche Morgan Grenfell will also assist Telepanel with establishing a minimum US$50 million vendor financing facility to fund its ESL Rental Program. The Rental Program will enable retailers to obtain the substantial benefits of Telepanel's ESL system with minimal up-front capital cost, providing improved margins and cash flow to the retailer from the outset. In addition, the retailer will have more flexibility and less technology risk than with traditional ESL purchase or lease options.

The loss for the year increased 5.6% over last year, mainly due to the loss on equity investment of $390,153, which was Telepanel's share of the expenses associated with the establishment, start-up and initial operations of Telepanel Europe S.A. The loss was also affected by the increase in the amortization of debenture discount and debenture interest expense over last year, as fiscal 1997 was the first full year that the debenture was outstanding. Additionally, depreciation and amortization increased and interest revenue declined. These items increased $811,000 from the prior year.

Telepanel continues to lead the ESL industry, with the largest installed base of any participant – 85 stores comprised of over 1.2 million display modules, and with a backlog of 82 stores and a potential order back-log of up to 138 additional stores, including 50 stores under the recently announced Rental Program.

I would like to take this opportunity to extend my gratitude to Telepanel's customers, suppliers, shareholders and employees, whose efforts and support are key to the company's continued success.

Sincerely yours,



Chris Skillen
President and Chief Executive Officer

AUDITORS' REPORT

To the Shareholders of
Telepanel Systems Inc.

We have audited the consolidated balance sheets of Telepanel Systems Inc. as at January 31, 1997 and 1996 and the consolidated statements of operations and deficit and changes in financial position for each of the years in the three-year period ended January 31, 1997. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at January 31, 1997 and 1996 and the results of its operations and the changes in its financial position for each of the years in the three-year period ended January 31, 1997 in accordance with generally accepted accounting principles in Canada.

Price Waterhouse

Chartered Accountants

Toronto, Canada

March 20, 1997

CONSOLIDATED BALANCE SHEETS

(in Canadian dollars)

	January 31 1997	1996
Assets		
Current assets		
Cash and short-term investments	$ 3,943,817	$ 5,146,469
Accounts receivable *(Note 3)*	473,228	534,829
Inventories *(Note 4)*	2,373,915	2,094,981
Prepaid expenses	13,306	23,287
	6,804,266	7,799,566
Investment in Telepanel Europe S.A. *(Note 5)*	277,568	–
Capital assets *(Note 6)*	601,149	707,866
Deferred expense	–	152,728
	$ 7,682,983	$ 8,660,160
Liabilities		
Current liabilities		
Bank and other indebtedness *(Note 7)*	$ 1,430,000	$ 700,000
Accounts payable and accrued liabilities *(Note 8)*	769,415	983,194
	2,199,415	1,683,194
Debenture *(Note 9)*	2,094,864	1,713,753
Shareholders' Equity		
Capital stock and warrants *(Note 10)*	30,905,776	28,417,666
Deficit	(27,517,072)	(23,154,453)
	3,388,704	5,263,213
	$ 7,682,983	$ 8,660,160

See accompanying notes to financial statements.

Approved by the Board

Director

Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

(in Canadian dollars)

	Years ended January 31		
	1997	1996	1995
Product sales	$ 2,856,425	$ 2,947,086	$ 3,381,131
Expenses			
Manufacturing	2,304,886	3,885,093	4,023,591
Selling, general and administration	3,116,776	2,237,692	1,988,738
Research and development	499,034	438,456	476,041
Depreciation and amortization	304,441	239,816	178,650
Amortization of debenture discount *(Note 9)*	381,111	238,194	–
Debenture interest	338,745	213,786	–
Other interest	67,425	97,942	71,869
	7,012,418	7,350,979	6,738,889
Loss from operations before the undernoted items	(4,155,993)	(4,403,893)	(3,357,758)
Interest earned	183,527	272,189	206,639
Equity loss in Telepanel Europe S.A. *(Note 5)*	(390,153)	–	–
	(206,626)	272,189	206,639
Loss for the year	(4,362,619)	(4,131,704)	(3,151,119)
Deficit, beginning of year	(23,154,453)	(19,022,749)	(15,871,630)
Deficit, end of year	$ (27,517,072)	$ (23,154,453)	$ (19,022,749)
Loss per common share	$ (0.25)	$ (0.26)	$ (0.22)

See accompanying notes to financial statements.

Pricing accuracy is one of the keys to customer satisfaction, confidence and store loyalty.

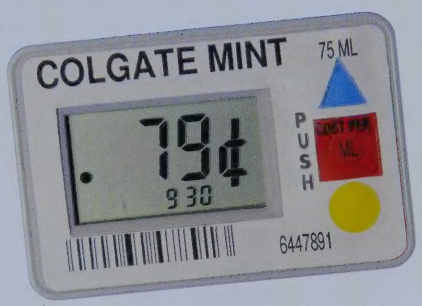
With Telepanel, prices at the shelf edge and the checkout are identical.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

(in Canadian dollars)

	Years ended January 31		
	1997	1996	1995
Cash provided by (used in)			
Operating activities			
Loss for the year	$ (4,362,619)	$ (4,131,704)	$ (3,151,119)
Items not requiring a current outlay of cash			
Depreciation and amortization	685,552	478,010	178,650
Equity loss in Telepanel Europe S.A.	390,153	–	–
Changes in noncash working capital *(Note 12)*	(421,131)	446,149	(1,503,722)
	(3,708,045)	(3,207,545)	(4,476,191)
Financing activities			
Issuance of common shares and warrants	2,488,110	4,792,186	1,205,132
Bank and other indebtedness	730,000	(855,524)	1,295,821
Issuance of debenture	–	1,475,559	–
	3,218,110	5,412,221	2,500,953
Investing activities			
Equity investment in Telepanel Europe S.A.	(667,721)	–	–
Purchase of capital assets, net	(44,996)	(288,571)	(188,641)
Short–term deposits	–	–	2,000,000
	(712,717)	(288,571)	1,811,359
Increase (decrease) in cash during the year	(1,202,652)	1,916,105	(163,879)
Cash, beginning of year	5,146,469	3,230,364	3,394,243
Cash, end of year	$ 3,943,817	$ 5,146,469	$ 3,230,364
Supplemental information			
Interest paid	$ 377,480	$ 311,728	$ 71,869

See accompanying notes to financial statements.



Display modules shown at actual size

Telepanel's wireless electronic shelf labels are the most reliable and cost effective available.

1. Nature of operations

Telepanel Systems Inc. (the "company") is a developer, manufacturer and supplier of an electronic shelf pricing and information system for use in the retail industry and, in particular, the supermarket industry. The system enables supermarkets to change product pricing at the shelf by the use of a central computer and radio frequency communications technology. The company commenced operations in the North American retail supermarket industry and in September 1996 established a company in Europe in conjunction with other investors to market its products.

2. General and summary of significant accounting policies

The consolidated financial statements of the company have been prepared in accordance with accounting policies generally accepted in Canada, which, except as described in Note 16, conform in all material respects to accounting policies generally accepted in the United States. The principal accounting policies followed by the company, which have been consistently applied, are summarized as follows:

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of financial statement presentation

The financial statements of the company's wholly-owned subsidiary, Telepanel Products Inc., are consolidated. All significant intercompany balances and transactions have been eliminated upon consolidation. Telepanel Europe S.A., an entity not controlled, but which the company has the ability to exercise significant influence over, is accounted for using the equity method.

Short-term investments

Short-term investments comprise highly-liquid instruments which have original maturities of less than three months.

Inventories

Inventories are valued at the lower of cost (determined using the first-in, first-out method) and net realizable value. The cost of work in progress and finished goods includes the cost of raw materials, direct labour and related overhead expenses.

Capital assets

Capital assets are recorded at cost. Depreciation is calculated on a declining-balance basis over the estimated useful lives of the assets at the following annual rates:

Computer equipment	30%
Furniture and equipment	20%

Maintenance and repair costs are expensed as incurred.

Revenue recognition

Revenue from the sale of products is recognized at the time the company has completed its contractual commitments with respect to the sale.

Financial instruments

Financial instruments are initially recorded at historical cost. If subsequent circumstances indicate that a decline in the fair value of a financial asset is other than temporary, the financial asset is written down to its fair value. Unless otherwise indicated, the fair values of financial instruments approximate their recorded amounts.

The estimated fair value of the company's cash and short-term investments, accounts receivable, bank and other indebtedness and accounts payable and accrued liabilities approximates their carrying values because of their relatively short-term maturity. The estimated fair value of the company's debenture is estimated using discounted cash flow analysis, based on the company's current incremental rates for similar types of borrowing arrangements.

Translation of foreign currencies

The company's foreign subsidiary, Telepanel Products Inc., is classified as integrated.

Current assets (excluding inventories) and current liabilities are translated at the rates in effect at the balance sheet dates, whereas other assets and other liabilities are translated at rates prevailing at the respective transaction dates. Revenues and expenses are translated at average rates prevailing during the year, except for cost of inventory used and depreciation, which are translated at exchange rates prevailing when the related assets were manufactured or acquired. Currency gains and losses are reflected in operations for the year.

Stock options
Stock options are valued using the intrinsic method.

3 Accounts receivable
Included in accounts receivable at January 31, 1997 is a receivable from Telepanel Europe S.A. of $62,416 (1996 – a $60,000 noninterest bearing secured advance to an officer of the company).

4 Inventories

	1997	1996
Raw materials	$ 437,018	$ 745,058
Work in progress	181,404	67,480
Finished goods	1,528,858	1,184,863
Deposits on purchases	226,635	97,580
	$ 2,373,915	$ 2,094,981

5 Investment in Telepanel Europe S.A.
During September 1996, the company formed Telepanel Europe S.A. ("Telepanel Europe") in conjunction with other investors to market its products. The company owns a 49% equity interest in Telepanel Europe which is accounted for using the equity method. The company has the right to purchase the other investors' equity in Telepanel Europe, and the other investors have the right to require the company to purchase their equity in Telepanel Europe, after June 30, 1998 and before December 31, 2006, subject to profitability requirements for the company and Telepanel Europe, for either cash or shares of the company. The purchase price would be determined according to the earnings per share of Telepanel Europe and the price earnings' ratio of the company's shares. The shareholders have committed to investing an additional $5.5 million in Telepanel Europe of which the company's commitment approximates $1.8 million.

6 Capital assets

	1997			1996		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
Computer equipment	$ 275,245	$ 222,179	$ 53,066	$ 269,591	$ 200,648	$ 68,943
Furniture and equipment						
Manufacturing	1,117,477	578,054	539,423	1,083,047	449,422	633,625
Office	43,668	35,008	8,660	38,755	33,457	5,298
	$ 1,436,390	$ 835,241	$ 601,149	$ 1,391,393	$ 683,527	$ 707,866

7 Bank and other indebtedness
The company has an $800,000 operating line of credit with a nonbanking institution bearing interest of 10% at January 31, 1997 (1996 – 11%). On January 31, 1997, the balance drawn on this line was $680,000 (1996 – $Nil). This line is secured by a fixed and floating charge on all assets and a specific assignment of export receivables financed. The company also has a $1,000,000 bank operating loan bearing interest at prime plus $1\frac{3}{4}$%, which is secured by certain term deposits and a general security agreement. There are certain covenants, including financial ratios, which must be complied with. On January 31, 1997, the balance drawn on this line was $750,000 (1996 – $700,000).

The weighted average interest rates on bank and other indebtedness for the three fiscal years ended January 31, 1997 are 7.98%; 1996 – 11.07%; and 1995 – 8.88%.

8 Accounts payable and accrued liabilities

	1997	1996
Accounts payable	$ 265,682	$ 625,571
Accrued payroll costs	201,463	103,123
Other accruals	302,270	234,500
	$ 769,415	$ 963,194

9 Debenture and unamortized financing costs and debt discount
On June 15, 1995, the company issued a $3,000,000 debenture repayable at any time before June 15, 1999, bearing interest of 11.26% per year. The debenture is secured by a fixed and floating charge on all assets of the company subordinate to security for bank and other indebtedness. The company simultaneously issued 1,200,000 warrants exercisable at $2.50 per share expiring June 15, 2000 to the debenture holder. The total consideration received for the debenture and the warrants amounted to $3,000,000.

There are certain covenants, including financial ratios, which must be complied with. The company is required to make annual principal payments 90 days after the annual fiscal year-end based on a definition of available net cash. No annual payment is required in 1997.

The carrying value assigned to the debenture and the warrants was $1,475,559 and $1,373,875, respectively. The cost of issuing the debenture was $150,566. These costs and the discount related to the warrants will be amortized over the four-year term of the debenture. During the year $381,111 (1996 – $238,194) was amortized.

The carrying value of the debenture comprises:

	1997	1996
Principal amount of debenture payable	$ 3,000,000	$ 3,000,000
Less: Unamortized financing costs and debt discount	905,136	1,286,247
	$ 2,094,864	$ 1,713,753

The estimated fair value of the debenture is $3,161,000 (1996 – $3,000,000).

10 Capital stock and warrants

Authorized and issued share capital

Authorized capital comprises an unlimited number of common shares.

	1997		1996		1995	
	Shares	Amount	Shares	Amount	Shares	Amount
Capital stock						
Balance, beginning of year	16,557,113	$ 26,992,542	14,967,781	$ 23,569,902	14,165,557	$ 22,420,348
Shares issued for cash						
Issue of shares, net of costs of $15,390 (1996 – $221,740)	1,000,000	2,334,610	1,238,593	2,778,752	–	–
Issue of shares on exercise of warrants and options	–	–	214,210	322,161	761,750	976,638
Shares issued under compensation plan	62,047	128,600	136,529	321,727	26,474	75,000
Shares issued for services and acquisition of capital assets	11,364	24,900	–	–	14,000	97,916
Balance, end of year	17,630,524	29,480,652	16,557,113	26,992,542	14,967,781	23,569,902
Warrants						
Balance, beginning of year	–	1,425,124	–	55,578	–	–
Warrants issued for services, net of costs of $14,422	–	–	–	–	–	55,578
Warrants issued as part of debenture financing, net of costs of $4,329 *(Note 9)*	–	–	–	1,369,546	–	–
Balance, end of year	–	1,425,124	–	1,425,124	–	55,578
Total capital stock and warrants	17,630,524	$ 30,905,776	16,557,113	$ 28,417,666	14,967,781	$ 23,625,480

The number of warrants exercisable and changes in the warrants are as follows:

	Number of warrants to purchase shares at $2.50 per share	Number of warrants to purchase shares at $3.65 per share	Number of warrants to purchase shares at $1.30 per share	Total warrants	Exercise amount
Balance, January 31, 1994	–	–	700,500	700,500	$ 910,650
Exercised	–	–	(700,500)	(700,500)	(910,650)
Issued	–	40,000	–	40,000	146,000
Balance, January 31, 1995	–	40,000	–	40,000	146,000
Issued	1,200,000	–	–	1,200,000	3,000,000
Balance, January 31, 1997 and 1996	1,200,000	40,000	–	1,240,000	$ 3,146,000

The warrants to purchase shares at $2.50 and $3.65 per share expire on June 15, 2000 and August 28, 1999, respectively.

The company has an incentive plan under which options to purchase common shares may be granted to its directors, officers and employees at the discretion of the Board of Directors. Each option under the incentive plan, which allows for the purchase of one share, expires not later than 10 years from the date on which it was granted; however, all options granted to date have been for a three to five-year term. The option exercise price is set at the market value at the grant date.

The number of shares issuable under options and the average option price per share are as follows:

	Shares issuable under options			Average price per share		
	1997	1996	1995	1997	1996	1995
Shares issuable under options, beginning of year	1,767,500	1,295,210	1,208,460	$ 3.53	$ 4.08	$3.84
Granted	1,333,000	840,000	168,000	2.18	2.38	4.88
Exercised	–	(214,210)	(61,250)	–	1.50	1.08
Expired	(55,000)	(153,500)	(20,000)	2.12	4.67	5.13
Shares issuable under options, end of year	3,045,500	1,767,500	1,295,210	$ 2.96	$ 3.53	$4.08

The options outstanding as at January 31, 1997 to purchase common shares are as follows:

Number of shares	Exercise price range	Fiscal year of expiry
491,000	$ 2.55	January 31, 1998
451,000	4.20 – 8.375	January 31, 1999
70,000	1.80 – 7.50	January 31, 2000
715,500	1.70 – 2.50	January 31, 2001
1,318,000	1.90 – 2.50	January 31, 2002
3,045,500		

At January 31, 1997, 972,875 of the above options were not exercisable. Out of these options, 532,125 become exercisable in the fiscal year ending January 31, 1998, 340,750 become exercisable in the fiscal year ending January 31, 1999, and 100,000 become exercisable in the fiscal year ending January 31, 2000.

11 Loss per common share

Loss per common share is based on the weighted average number of shares outstanding during 1997, 1996, and 1995 of 17,138,214, 15,972,660 and 14,345,740 shares, respectively.

12 Consolidated statement of changes in financial position

Changes in noncash operating working capital are as follows:

	1997	1996	1995
Decrease (increase) in current assets			
Accounts receivable	$ 61,601	$ 57,548	$ (421,959)
Inventories	(278,934)	133,714	(1,325,130)
Prepaid expenses	9,981	140,156	(125,672)
Increase (decrease) in current liabilities			
Accounts payable & accrued liabilities	(213,779)	114,731	369,039
	$ (421,131)	$ 446,149	$ (1,503,722)

13 Strategic alliances and product sales

The company has a sales agreement with International Business Machine Corporation ("IBM") to September 1997 which accounts for a significant portion of the company's product sales, whereby IBM has a right to market the company's products in North America.

During the year, the company granted an exclusive licence to Telepanel Europe S.A. to market its products in Europe, the Middle East and Africa. The company has also committed to supply Telepanel Europe S.A. with its products at full cost.

Export sales to the United States for the three fiscal years ended January 31, 1997 (which are primarily made in U.S. dollars) amounted to $2,277,354; 1996 – $1,903,739; and 1995 – $2,622,342. Sales to Telepanel Europe for the year ended January 31, 1997 amounted to $125,667. The remainder of the company's product sales are in Canada.

The percentage of product sales by individual customer which account for more than 10% of revenue are as follows:

	Percentage by customer	
	First customer	Second customer
Year ended January 31		
1997	13.38	N/A
1996	56.90	35.40
1995	74.20	22.40

14 Income taxes

As at January 31, 1997, the company has losses available to be carried forward for income tax purposes amounting to approximately $13,497,000, which can be applied against future taxable income. These losses expire as follows:

1998	$ 935,000
1999	347,000
2000	676,000
2001	2,524,000
2002	2,556,000
2003	3,517,000
2004	2,942,000
	$ 13,497,000

As at January 31, 1997, the company has unclaimed research and development expenditures amounting to approximately $6,265,000, which can be applied to reduce future taxable income and are not subject to expiry. The tax benefit of the losses carried forward and unclaimed research and development expenditures have not been recorded in the financial statements.

A reconciliation of the income tax recovery at the combined federal and provincial taxation rate to the provision for income taxes is set out below:

	1997	1996	1995
Loss for the year	$ (4,362,619)	$ (4,131,704)	$ (3,151,119)
Combined federal and provincial taxation rate	44.6%	44.6%	44.3%
Income tax recovery at combined federal and provincial taxation rate	$ (1,946,000)	$ (1,843,000)	$ (1,396,000)
Manufacturing and processing rate reduction	105,000	116,000	88,000
Effect of subsidiary company loss at lower tax rate	38,000	61,000	100,000
Nondeductibility of equity loss and expenses	347,000	106,000	–
Tax benefit of loss not recorded	1,456,000	1,560,000	1,208,000
Provision for income taxes	$ –	$ –	$ –

15 Rental expense

Rental expense for the three fiscal years ended January 31, 1997, 1996 and 1995 are approximately $106,000, $97,000 and $106,000, respectively.

16 Reconciliation to United States generally accepted accounting principles

Reconciliation of loss determined in accordance with generally accepted accounting principles in Canada to loss determined under accounting principles which are generally accepted in the United States, is as follows:

	1997	1996	1995
Loss for the year, as reported	$ (4,362,619)	$ (4,131,704)	$ (3,151,119)
Amortization of deferred marketing expense (1)	152,728	90,390	52,987
Loss for the year in accordance with United States accounting principles	$ (4,209,891)	$ (4,041,314)	$ (3,098,132)
Loss per share in accordance with United States accounting principles	$ (0.25)	$ (0.25)	$ (0.22)

(1) Under United States generally accepted accounting principles, the deferred marketing expense would be expensed in the year incurred.

On October 7, 1993, the shareholders approved a resolution to reduce the deficit and capital stock of the company by $9,052,137. Generally accepted accounting principles in the United States does not allow such a reduction in capital stock. Accordingly, capital stock and deficit of the company would be $9,052,137 greater under United States accounting principles for each of the years presented.

Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("FAS 109") requires the liability method under which temporary differences are tax effected at current rates, whereas under Canadian generally accepted accounting principles, timing differences are tax effected at the rates in effect when they arise.

The deferred tax asset consists of:

	1997	1996
Net operating loss carryforwards	$ 5,658,400	$ 4,776,708
Unclaimed research and development costs	2,618,770	2,467,380
Investment tax credits	1,031,084	979,409
Other	410,538	344,294
	9,718,792	8,567,791
Valuation allowance	(9,718,792)	(8,567,791)
	$ –	$ –

Accounting policies generally accepted in the United States require the consolidated statements of changes in financial position to reflect financing and investing activities on a cash basis.

Accordingly, the operating, financing and investing activities in the consolidated statements of changes in financial position in accordance with accounting policies generally accepted in the United States are as follows:

	1997	1996	1995
Cash provided by (used in)			
Operating activities			
Loss for the year	$ (4,209,891)	$ (4,041,314)	$ (3,098,132)
Items not requiring a current outlay of cash			
Common shares and warrants issued for services	153,500	321,727	228,494
Depreciation and amortization	532,824	387,620	125,663
Equity loss in Telepanel Europe	390,153	–	–
Changes in noncash working capital	(421,131)	446,149	(1,503,722)
	(3,554,545)	(2,885,818)	(4,247,697)
Financing activities			
Issuance of common shares and warrants	2,334,610	4,470,459	976,638
Bank and other indebtedness	730,000	(855,524)	1,295,821
Debenture (Note 9)	–	1,475,559	–
	3,064,610	5,090,494	2,272,459
Investing activities			
Equity investment in Telepanel Europe	(667,721)	–	–
Purchase of capital assets, net	(44,996)	(288,571)	(188,641)
Short-term deposits	–	–	2,000,000
	(712,717)	(288,571)	1,811,359
Increase (decrease) in cash during the year	$ (1,202,652)	$ 1,916,105	$ (163,879)

SFAS No. 123 requires proforma disclosures of loss and loss per share, as if the fair value based method of accounting for employee stock options had been applied. The company adopted SFAS No. 123 effective February 1, 1996 for options granted starting in 1995. Compensation cost is based on the fair value of the award using the Black-Scholes option-pricing model. The disclosures in the table show the company's loss and loss per share after including the effect of the compensation cost.

	1997	1996
Loss	$ (5,414,603)	$ (4,617,784)
Loss per share	(0.30)	(0.28)
Assumptions		
Risk-free interest rates	5%	5%
Expected lives	4 years	4 years
Volatility	63.2%	84.7%

TELEPANEL SYSTEMS INC

Telepanel... setting the world standard for electronic shelf labelling systems.

Corporate Information

Address:
Telepanel Systems Inc.
245 Riviera Drive
Markham, Ontario, Canada L3R 5J9
(905) 477-7877 Fax (905) 477-9528

Auditors:
Price Waterhouse
1 First Canadian Place
Suite 3300, Box 190
Toronto, Ontario, Canada M5X 1H7

Stock Listings:
The Toronto Stock Exchange
Trading Symbol TLS

NASDAQ
Trading Symbol TLSIF

Transfer Agents & Registrar:
Montreal Trust Company
151 Front Street West
Suite 800
Toronto, Ontario, Canada M5J 2N1

Board of Directors:

Christopher R. Skillen
Chief Executive Officer
Telepanel Systems Inc.

Robert O. Aders
Chairman
The Advisory Board

Donald W. Paterson
President
Cavandale Corporation

Barry J. Reiter
Partner
Tory Tory DesLauriers & Binnington

Joseph Riz
Managing Director
Tricapital Management Limited

Brian A. Robbins
President and Chief Executive Officer
Exco Technologies Limited

Paul F. Starita
Chairman
CIBC Securities Inc.

M. Kathy Vieth
Consultant
Vieth and Associates

Officers:

Joseph Riz
Chairman

Christopher R. Skillen
President and Chief Executive Officer

Garth L. Aasen
Executive Vice President,
Sales and Marketing

Gregory P. Miller
Executive Vice President Operations

John C. Heaven
Vice President, Finance and Secretary